IN THE HIGH COURT OF JUDICATURE AT BOMBAY

CIVIL APPELLATE JURISDICTION

WRIT PETITION NO. 4327 OF 2004

1. The Maharashtra Urban Co-operative Banks')
Federation Limited,)
having its office at)
Bharatiya Krida Mandir, 4th floor, P.B. No.7120)
Wadala, Mumbai-400 031.)

2. The Malad Sahakari Bank Limited,)
having its)
Registered and Central Office at 6, Sujata,)
1st floor, Ranisati Marg, Malad (East),)
Mumbai-400 097.)

3. Janalaxmi Co-operative Bank Limited,)
(Scheduled Bank), having its Head Office at)
"Samruddhi", Gadkari Chowk, Old Agra Road,)
Nasik-422 002, Maharashtra.)

4. Chantilal M.Chauhan, Chairman,)
The Malad Sahakari Bank Ltd., 1st floor,)
Ranisati Marg, Malad (East), Mumbai-400 097)

5. Madhavrao B. Patil, Chairman,)
Janalaxmi Co-operative Bank Ltd.,)
"Samruddhi", Gadkari Chowk,)
Old Agra Road, Nasik-422 002, Maharashtra.)..Petitioners

Versus

1. Union of India.)

2. Reserve Bank of India, having its office at)

Shahid Bhagat Singh Road, Fort,)
Mumbai-400 001.)

3. Reserve Bank of India,)
Urban Banks' Department,)
Garment House, Worli,)
Mumbai-400 018)

4. The Governor, Reserve Bank of India,)
Shahid Bhagat Singh Road, Fort,)
Mumbai-400 001.)

5. The Deputy Governor, Reserve Bank of India,)
Shahid Bhagat Singh Road, Fort,)
Mumbai-400 001.)

6. The Commissioner for Co-operation and)
Registrar of Co-operative Societies,)
Maharashtra State, Central Building, Pune.)

7. The State of Maharashtra)..
Respondents

Dr. B.R. Naik instructed by Mr. Y.R. Naik for the petitioners.

Mr. D.A. Dubey with Mr. R.C. Master for Respondent No.1.

Dr. Virendra Tulzapurkar with Mr. Yogesh Chawak instructed by M/s. Udwadia & Udeshi for respondent Nos. 2 to 5.

with

ORIGINAL SIDE

WRIT PETITION NO. 1305 OF 2004

1. The Municipal Co-op. Bank Ltd.,)
a Co-operative Society registered under)
the Maharashtra Co-op.Societies Act, 1960.)

2. A.B. Adivarekar, Director.)

3. D.T.Chavan, Director,)

All at Fort Market Building, Shahid)
Bhagat Singh Marg, Mumbai-400 001.)..Petitioners

Versus

The Reserve Bank of India,)
a statutory body created by the Reserve Bank)
of India Act, Central Office: Urban Bank Dept.,)
2nd Floor, Garment House, Worli,)
Mumbai-400 018.)..Respondent

Mr. C.J. Sawant, Senior Counsel, with Mr. N.M. Makandar instructed by Mr. P.N. Shastri for the petitioners.

Dr. Virendra Tulzapurkar with Mr. Yogesh Chawak instructed by M/s. Udwadia & Udeshi for respondent.

CORAM: DALVEER BHANDARI, C.J. &
DR. D.Y. CHANDRACHUD,J.

Date of reserving the Judgment. : **30th September, 2004.**

Date of pronouncing the Judgment. : 27th **October, 2004.**

JUDGMENT (Per Dalveer Bhandari, C.J.)

1. In these Writ Petitions , the petitioners have challenged the validity and legality of the circular dated 29th April, 2003 issued by the Reserve Bank of India. We, therefore, propose to dispose of both these petitions by a common judgment.

2. To appreciate the controversy raised in these Petitions , few relevant facts of the first Writ Petition No. 4327 of 2004 are recapitulated:

The petitioners are Co-operative Societies registered under the Maharashtra Co-operative Societies Act, 1960 (hereinafter referred to as "the Act"). Petitioner No.1 is a Federation of Urban Co-operative Banks in the State of Maharashtra. Petitioner No.1 has about 516 Urban Co-operative Banks as its members in the State of Maharashtra. Petitioner Nos. 2 and 3 are Primary Co-operative Banks who were members of the first petitioner. Petitioner No.1 is engaged in providing assistance

to Urban Co-operative Banks in the State of Maharashtra. The second petitioner in past had provided financial accommodation to its Directors and/or their relatives to the extent of Rs.47.47 lakhs or thereabouts which amount is outstanding as on 31st December, 2003.

3. The third petitioner, Janalaxmi Co-operative Bank Limited, has provided loans and financial accommodation to their Directors and their relatives in the past. The loans and/or financial accommodation granted by petitioner Nos. 2 and 3 to their Directors and/or relatives in the past are in accordance with the Reserve Bank of India (for short, 'R.B.I.') directives. However, the R.B.I. vide its directives dated 29th April, 2003 put a ban on loans and advances to Directors and their relatives and the firms/companies/concerns in which such Directors are interested. The petitioners have challenged the validity of the said circular dated 29th April, 2003 and the show cause notice dated 31st March, 2004, issued to the petitioners in Writ Petition No. 1305 of 2004. The said circular has also been challenged

in Writ Petition No. 4327 of 2004. The relevant portion of the explanatory letter to the said circular reads as under:

> "Please refer to our Directives No. UBD.DS.PCB.5/13.05.00/1993-94 dated May 26, 1994 and No. UBD.DS.DIR.3/13.05.00/2002-03 dated December 4, 2002 in terms of which the overall ceiling for loans and advances (both secured and unsecured) to all directors, their relatives and concerns in which they are interested has been brought down from the earlier ceiling of 10 per cent of the bank's demand and time liabilities (DTL) of 5 per cent of its DTL.
>
> 2. ... .
>
> 3. In line with the above recommendations of the JPC, the Reserve Bank has announced its policy in paragraph 116 of the Monetary and Credit Policy for the year 2003-04 (copy of the paragraph enclosed). Accordingly, primary (urban) co-operative banks are prohibited from extending any loans and advances (both secured and unsecured to the directors, their relatives and the firms/concerns/companies in which they are interested, with immediate effect. The existing advances extended prior to April 29, 2003 may be allowed to continue up to the date when they are due. The advances should not be renewed or extended further. The other instructions contained in the above directive remain unchanged."

4. By these petitions, the petitioners challenge the validity of the said total prohibition ordered by R.B.I. to all Primary Urban Co-operative Banks to give loans and/or finances to their Directors or relatives or firms or concerns in which such Directors are interested. The petitioners have challenged the validity of the said circular as, according to the petitioners, the same is illegal, void and inoperative in law and cannot be sustained.

5. According to the petitioners, the ban on loans to Directors of Urban Co-operative Banks and their relatives, and the firms/companies/concerns in which they are interested was initially imposed with a limit on aggregate loans to all Directors at 10% of demand and time liabilities. The said initial restriction of 10% was thereafter reduced to 5%. Now, by the impugned circulars/orders of the R.B.I., there is total ban on loans and advances to Directors and their relatives, and the firms/companies/concerns in which they are interested. It may be pertinent to note that the said circulars of the R.B.I. were issued on the recommendations of the Joint Parliamentary Committee (for short, 'J.P.C.') of Stock Market Scam and

matters relating thereto.

6. In response to the show-cause notice issued by this Court, respondent-Reserve Bank of India has filed an affidavit of Shri B.L. Bomma, Deputy General Manager. It is incorporated in the affidavit that the respondent is a statutory body constituted under Section 3 of the Reserve Bank of India Act, 1934 (hereinafter "the RBI Act") to regulate the issue of Bank notes and keeping of the reserves with a view to securing monetary stability in India and to operate the currency and credit system of the country to its advantage as per preamble of the RBI Act. It is stated in the said affidavit that on 27th April, 2001, the J.P.C. was constituted on the motion by the Government to enquire into the stock market scam and matters relating thereto. The JPC in paragraph 5.66 of Vol.I of its report recommended imposition of full ban on granting of loans and advances to the directors and their relatives and to concerns in which they were interested. The conclusions of the Committee were that the stock market scam was at the instance of some

main players in the market. It also found wrong doings by some Banks that had contributed significantly towards the scam. The J.P.C. found that the scam was basically manipulation of the capital market to the benefit of market operators, brokers, entities and their promoters and managements. It was also found that certain Co-operative Banks, Stock Exchanges, corporate bodies and financial institutions were willing to facilitate in the scam. Large number of Co-operative Banks and Unit Trust were victims of the scam. The J.P.C. took a serious note that the Chairman and top Executives of Madhavpura Mercantile Co-operative Bank Ltd. had indulged in a series of irregularities. It was also found that certain other Co-operative Banks such as City Co-operative Bank had flouted prudential norms of the R.B.I.

7. Dr. Tulzapurkar, learned Counsel appearing for the respondents, has drawn our attention to the episode of *Madhavpura Mercantile Co-operative Bank Limited*. The said Bank was registered under the Gujarat State Co-operative

Societies Act, 1961. The deposits and advances of the Bank stood at Rs.1262.37 crores and Rs.1717.36 crores, respectively, as on 31st March, 2000. Till 13th March, 2001, the affairs of the Bank were managed by an elected Board of Directors which comprised eleven directors. On 9th March, 2001, there was a sudden rush of depositors at the different branches of the Bank at Ahmedabad for withdrawal of their deposits, which increased steadily upto 12th March, 2001 and was caused by strong rumours that the Bank had extended guarantees to one Ketan Parekh, a leading stock broker at Mumbai, who had suffered huge losses in his share dealings. An officer from Urban Banks Department of R.B.I. at Ahmedabad was deputed to the Bank's Head Office to ascertain the factual position and also whether the Bank had any account in the name of Ketan Parekh. Because of the heavy demand by the depositors, several Co-operative Banks not only in Ahmedabad but also in other towns of Gujarat suffered heavy losses and closed its shutters.

1. Dr. Tulzapurkar has also placed on record a statement showing loans and advances to the directors of some of the Co-operative Banks as on 31st December, 2002. Out of 64 such Banks, as far as 11 Banks were concerned, the Non Performing Assets had become 100 per cent. In case of 9 Banks from 76 per cent to 99 per cent, 10 Banks from 51 to 75 per cent, 10 banks from 26 per cent to 50 per cent and 24 Banks from 0 per cent to 25 per cent. All this material was considered by the Reserve Bank of India and based on the recommendation of the JPC, the Reserve Bank of India in exercise of its power under Section 35A of the Banking Regulation Act, 1949 issued the circular. Section 35A reads as under:

"35A. Power of the Reserve Bank to give directions:-

(1) Where the reserve Bank is satisfied that -

(a) in the public interest; or

(aa) in the interest of banking policy; or

(b) to prevent the affairs of any co-operative bank being conducted in a manner detrimental to the interests of the depositor or in a manner prejudicial to the interests of the co-operative bank; or

© to secure the proper management of any banking business of any co-operative bank generally;

it is necessary to issue directions to co-operative banks generally or to any co-operative bank in particular, it may, from time to time, issue such directions as it deems fit, and the co-operative banks or the co-operative bank, as the case may be, shall be bound to comply with such directions.

(2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect."

2. Dr. Tulzapurkar in support of his submission has placed reliance on the decision of the single Judge of the Kerala High Court in Civil Writ Petition No. 4947 of 2004, *Johnny Kuruvilla, Kavilakudiyil, Katathi, Muvattupuzha vs. Reserve Bank of India and Anr.,* decided on 26th May, 2004. The learned single

Judge, while dismissing the petition, observed that the circulars had been intended to curb the mischief and were issued for public benefit and for the purpose of strengthening the economy. The court observed that basically the idea had been instilled because of the report of the J.P.C. When the J.P.C. had recommended that such measures are to be adopted, it would not have been justifiable on the part of the Reserve Bank of India to discard the suggestion particularly when they were issued in the larger public interest. The JPC was concerned about the financial well-being of the country. Regulations were issued in the public interest after due deliberations and there was nothing irregular about them or their validity and they operated as binding upon the Urban Banks. The Court observed that once we find that such measures were to curb the possible misuse of position of persons who were at the helms of affairs of Urban Banks. The petitioner therein as an individual account-holder having a clean record can have no relevance there when a policy decision is implemented. It is to be borne in mind that the

R.B.I. issues circular for the entire country and exception cannot be made in case of one or two Banks.

3. According to Section 35A, the R.B.I may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1) and in so modifying or cancelling any direction, may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect. Therefore, if sufficient material is placed before the R.B.I. by any aggrieved party, the R.B.I. in an appropriate case may consider the same.

4. Dr. Tulzapurkar also placed reliance on a judgment reported as *The Janata Sahakari Bank Ltd. and Anr. vs. The State of Maharashtra and Ors,* AIR 1993 SC 252. In this case, Section 35 of the Banking Regulation Act, 1949 came up for consideration of the Court. This case also pertains to Maharashtra Co-operative Societies Act. The Supreme Court observed that an overall responsibility to find out the well-being

of a Banking Company, in improving monetary stability and economic growth as well as keeping in view the interests of depositors, the R.B.I. has to formulate its policy vis-a-vis Banking Companies. If any management or supervision is to be done over the banking activities of a bank, it will have to be governed by banking policy. Regard will have to be given to the fact that Co-operative Banks, like any other Banking Companies, are entrusted with the funds from the public. The amounts are in trust with them which are payable on demand to the public and hence, deposits or the profits earned from the same or their capital have to be augmented, rather than depleted, and if excess amounts are likely to be depleted by way of donations for charitable and public purposes, the very stability of a Co-operative Bank comes in danger. The Court further observed thus:

> “We feel that 'banking policy' and 'banking' are not independent but coordinating subjects and both are covered within the supervisory powers of the Reserve Bank of India within the meaning of S. 35A of the Banking Regulation Act. Even otherwise, we

> feel that the directions issued by the Reserve Bank of India are in the larger interest of the public and the Reserve Bank of India being a body of experts in banking, the directions given by it should not be lightly brushed aside".

5. In the instant case, the directions issued by the R.B.I., by no stretch of imagination, can be called *mala fide* or issued on extraneous considerations. The Reserve Bank of India has issued these directions on the recommendation of the JPC, based on substantial material to ensure the safety of deposits with the Banks. The JPC also examined the issue and recommended imposition of ban on grant of loan to the Directors who formed a separate group from the ordinary members and they are vested with the management of funds. Utilisation of funds by the Directors to their own use is required to be prohibited in public interest and in the interest of depositors. Dr. Tulzapurkar submitted that the restrictions imposed by the circulars are reasonable and do not violate the provisions of the Constitution related to formation of Association. The circular has been issued in exercise of the

powers conferred under the provisions of the Banking Regulation Act, 1949 and is valid. The JPC came across certain instances where the loan against non-existing deposits and properties were granted by the Bank to its directors. Therefore, to curb such practice, total prohibition against granting of loan to directors was imposed and as such, the directors have no fundamental or legal right to borrow loan from the bank in which they are Directors. Clause (2) of Section 35A clearly gives power to Reserve Bank of India to modify or cancel any direction issued under sub-section (1) either on its own or on the representation made by the aggrieved party. We are confident that if any aggrieved party, including the petitioners, would make representation to the Reserve Bank of India on substantial material, the same would be considered by the Reserve Bank of India in accordance with the provisions of Section 35A.

6. According to the respondents, the challenge is totally

unsustainable. The Reserve Bank of India is a statutory body constituted under Section 3 of the Reserve Bank of India Act, 1934 to regulate issue of bank notes and keeping the reserves with a view to securing monetary stability in India and to operate the currency and credit system of the country to its advantage as per preamble of the Reserve Bank of India Act, 1934. In terms of Section 3 of the Reserve Bank of India Act, the R.B.I. has been established for the purpose of regulating banking business in India. The R.B.I. exercises control over the volume of credit in order to ensure economic stability. The R.B.I. regulates and supervises Commercial Banks and Co-operative Banks in India by virtue of the provisions of the Banking Regulation Act.

7. The R.B.I. has been issuing directives from time to time for regulating the grant of loans to Directors of Urban Co-operative Banks. It is part of its solemn duty and obligation of the R.B.I. Despite such directives, it was found that there had been a number of cases of misappropriation of huge amount of funds

of Co-operative Banks by the Directors by granting advances and loans to themselves and their relatives, firms, companies and concerns in which they were interested. The J.P.C. recommended a total ban on Urban Co-operative Banks against giving of loans and advances to their Directors.

1. The Reserve Bank of India also had material which showed that the Urban Co-operative Banks have been granting loans and advances to the Directors and their Companies, which were secured loans, but the borrowers were transferring the funds to other firms in which the Directors were interested. Thus, it was found that the provisions of Section 20 of the Banking Regulation Act as amended by Section 56 of the same Act were inadequate and the same regulate only the grant of unsecured loans to Directors. In view thereof, the R.B.I. issued the impugned directives.

2. We find no force in the challenge to the petition of the aforementioned circulars on the ground of violation of Article

14 of the Constitution. It is a settled position in law that if a law deals equally with members of a well defined class, it is not open to challenge of denial of equal protection on the ground that the law has no application to the other persons. In support of his submission, he placed reliance on a Constitution Bench Judgment of the Supreme Court in the case of *State of Bombay vs. F.N. Balsara,* AIR 1951 S.C. 318. The Court observed that there is nothing wrong in the Legislature according special treatment to persons who form a class by themselves in many respects and who have been treated as such in various enactments and statutory provisions.

3. In the celebrated case of *Chiranjit Lal vs. The Union of India*, AIR 1950 SCR 869, the Supreme Court observed that there is presumption in favour of the constitutionality of an enactment, since it must be assumed that the legislature understands and correctly appreciates the needs of its own people, that its laws are directed to problems made manifest by experience and its discriminations are based on adequate grounds. The Court

further observed that the principle of equality does not mean that every law must have universal application for all persons who are not by nature, attainment or circumstances in the same position and the varying needs of different classes of persons often require separate treatment. The Court also observed that the principle does not take away from the State the power of classifying persons for legitimate purposes. Every classification is in some degree likely to produce some inequality and mere production of inequality is not enough. The Court further observed that if a law deals equally with members of a well-defined class, it is not obnoxious and it is not open to the charge of denial of equal protection on the ground that it has no application to other persons.

18. In another Constitution Bench judgment in case of *Shri Ram Krishna Dalmia and Ors. vs. Shri Justice S.R. Tendolkar and Ors.,* AIR 1958 S.C. 538, the Supreme Court observed thus:

"(a) that a law may be constitutional even

though it relates to a single individual if, on account of some special circumstances or reasons applicable to him and not applicable to others, that single individual may be treated as a class by himself;

(b) that there is always a presumption in favour of the constitutionality of an enactment and the burden is upon him who attacks it to show that there has been a clear transgression of the constitutional principles;

© that it must be presumed that the legislature understands and correctly appreciates the need of its own people, that its laws are directed to problems made manifest by experience and that its discriminations are based on adequate grounds.

(d) that the Legislature is free to recognise degrees of harm and may confine its restrictions to those cases where the need is deemed to be the clearest;

(e) that in order to sustain the presumption of constitutionality the Court may take into consideration matters of common knowledge, matters of common report, the history of the times and many assume every state of facts which can be conceived existing at the time of legislation; and

(f) that while good faith and knowledge of the existing conditions on the part of a Legislature are to be presumed, if there is nothing on the face of the law or the surrounding circumstances brought to the notice of the Court on which the classification

> may reasonably be regarded as based, the presumption of constitutionality cannot be carried to the extent of always holding that there must be some undisclosed and unknown reasons for subjecting certain individuals or corporations to hostile or discriminating legislation".

19. Reliance has also been placed on the Judgment of the Apex Court in the matter of *Sakhawat Ali vs. State of Orissa,* reported in 1955 (1) SCR 1004. The Supreme Court observed that it is for the Legislature to determine that categories which would be covered by the scope of legislation and merely because certain categories which would stand on the same footing as those which are covered by legislation are left out, would not render the legislation, which has been enacted, in any manner discriminatory and violative of Article 14 of the Constitution. The State Co-operative Bank and Central District Co-operative Banks are class by themselves and are separate in functions and circulars are issued in the larger public interest in view of the findings and the recommendations of the J.P.C., as also in view of the material that was made available to the R.B.I. The

petitioners' challenge that justification on the basis of conflict of duty and interest being non-existent in view of the provisions of Section 20 of the Banking Regulation Act as amended by Section 56 of the same Act. It was noticed by the J.P.C. that though Section 20 of the Banking Regulation Act permitted grant of only secured loans to Directors, the amount received by way of such loans was transferred to other entities of the Directors. It was, therefore, found that the restriction contained in Section 20 of the Banking Regulation Act as applicable to the Co-operative Banks was inadequate. The grant of secured loans to the Directors of Co-operative Banks and thereafter the transfer of the amounts received by way of such loans to other firms in which they were interested established that there was a total misuse of power by Directors and a breach of the fiduciary duty to the shareholders of the Co-operative Banks and that there was a conflict of interest and duty resulting in collapse of the concerned Co-operative Bank leading to general reaction amongst other Co-operative Banks. The J.P.C. noticed the effect of the secured loans granted by

Mahdavpura Co-operative Bank to an entity of the Chairman, which entity thereafter transferred the amount to another entity in which the Chairman and the Directors were interested. In view of what has been observed in this paragraph that the contention that the justification of conflict of interest and duty is totally unsustainable.

20. We find no merit in the petitioners' challenge that the impugned circular and show cause notice are violative of Article 19 (1) © of the Constitution of India. All that the circular ensures is that the Urban Co-operative Banks do not grant any loans to the Directors or the relatives of the Directors or the entities in which such Directors are interested. The contention of the petitioners that by reason of such ban, there is a prohibition against formation of association is unsustainable.

21. It may be pertinent to mention that the impugned circular was issued by the respondents, keeping in mind the larger public interest of the Co-operative Banks, their shareholders as also

the depositors. The circular was, in fact, issued in furtherance of the objects sought to be achieved by the Banking Regulation Act and in particular, the provisions of Section 35A of the Banking Regulation Act. No infirmity or illegality has been pointed out by the petitioners in issuance of the aforementioned circular and the show-cause notice.

22. In view of our clear findings, both these writ petitions, being devoid of merit, are dismissed with costs.

CHIEF JUSTICE

DR. D.Y. CHANDRACHUD, J.